



Trust Deeds vs. Land Sale Contracts: Which to Use & When?

by

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Today we are seeing more seller carry-back real estate transactions. These are the transactions in which, for various reasons [*usually having to do with the buyer's lack of access to bank financing*], the seller agrees to carry back a security interest for some of the purchase price.

Example: Buyer, emerging from an earlier short sale or other distressed housing event, finds a property she would like to purchase today. The seller owns the property free and clear of any bank loans. Even though his consumer credit record is otherwise stellar, our buyer has one black mark on his credit report – the distressed housing event. As a result, she is unable to secure bank financing at today's rates, and is unwilling to obtain a “hard money” loan [i.e. a private loan at an astronomic interest rate and on draconian terms, including a harsh prepayment penalty]. She proposes to pay the seller 20% down in cash, and asks that the seller carry back a security interest on the property for the next five years, as she rebuilds her credit score to qualify for a conventional loan at a prime rate.

In such cases, the seller, and to a lesser extent the buyer,¹ may wonder what the best security arrangement is for their situation. In Oregon, the choice is typically between a promissory note and trust deed, or a land sale contract. Before discussing the perceived benefits of each, let's look at the basic differences between the two.

Note and Trust Deed. Oregon trust deeds are a statutorily recognized process for obtaining an interest in real property to secure an obligation for repayment of a loan – usually, but not always - a “purchase money loan,” i.e. a loan used to purchase the subject property.² In the event of a default, seller's remedies are set out by statute. [See, ORS 86.705 – 86-795.](#)

Here is a quick summary of the features of the transaction:

- Buyer signs a promissory note and trust deed for the remaining 80% of the purchase price that the seller has agreed to carry back.
 - The note promises to pay the money, and
 - The trust deed describes the seller's remedies if the buyer defaults under the note.

¹ I say “lesser extent,” since typically, it is the seller who will dictate the terms of this carry-back arrangement, not the buyer.

² A note and trust deed is also used for a home-equity line of credit, or “HELOC.”

- At time of closing the transaction, when the buyer executes a note and trust deed to the seller, the seller conveys title to the buyer. This means that: (a) The buyer now owns the property subject to the lien³ of the trust deed, and (b) The seller retains a recorded security interest in the property.
- Once the promissory note is paid in full, the lien of the trust deed is released by the recording of a “Deed of Reconveyance,” which is the functional equivalent of a “satisfaction of mortgage.” Upon recording the Deed of Reconveyance, the property is now free and clear of the lien of seller’s trust deed.

Land Sale Contract. With the exception of certain remedies on default, land sale contracts are not a creature of statute. The rights and duties of the parties are governed by the Common Law, i.e. appellate case law that has developed as “precedent” over the years. If the parties agreed to use a land sale contract rather than a note and trust deed,⁴ here is how the transaction would look:

- Seller and buyer would sign the contract setting forth the buyer’s repayment obligations and the seller’s remedies in the event of default;
- Significantly, no deed is conveyed from seller to buyer at closing. This means that the seller retains legal title, while the buyer has “equitable title.” The latter designation really means that the buyer has virtually all of the rights of an owner, but cannot convey legal title during the life of the contract.⁵
- Once the contract is paid off, the seller [*or escrow or collection company, if the seller pre-signed the deed*] will convey legal title to the buyer. Thereupon, the property is free and clear of the lien of the seller’s contract [*called a “vendor’s lien”*].

Pros and Cons. The primary differences between using a trust deed versus a land sale contract relate to the remedies available on default. The fact that the buyer under a land sale contract has “equitable title” as opposed to “legal title” when the trust deed is used, means very little in legal terms.

Note and Trust Deed. The seller’s primary remedy upon a buyer’s default is a statutory, non-judicial foreclosure. That is, the foreclosure process does not include the filing of a lawsuit in court; it is conducted non-judicially by following the statutorily described process, which includes mailing a notice to the buyer, and publication on the public record of the foreclosure sale date.⁶

- *Seller Advantage:* It is relatively fast, i.e. 130 – 150 days;
- *Seller Advantage:* There is no right of redemption to the buyer, i.e. there is no statutory period⁷ following the sale for the buyer to “repurchase” the property – the seller gets possession of the property almost immediately after the sale;
- *Buyer Advantage:* In a non-judicial foreclosure, there is no risk to the buyer of a “deficiency judgment” where he/she could be held liable if the seller’s net sale proceeds were less than the total debt due;

³ A “lien” is a charge against the property, the nonpayment of which allows the lienholder to foreclose, i.e. have the property sold to satisfy the debt.

⁴ Don’t be confused by the word “contract” here. Almost all agreements, including promissory notes and trust deeds, are “contracts” if they contain the necessary legal elements. The term “land sale contract” is used specifically to designate a contract between a seller and buyer that secures a repayment obligation for the purchase price.

⁵ For the layperson, there is really very little functional difference today.

⁶ Note: In certain cases, the seller could go to court to judicially foreclose the trust deed.

⁷ In a judicial foreclosure, the period of redemption is 180 days, i.e. six months.

- *Buyer Advantage:* Up to five days before the foreclosure sale, the buyer may “cure” the default, by paying the amount of the arrears, plus statutory costs and attorney fees. This reinstates the note and trust deed, and the buyer resumes the repayment regime described in the promissory note.

The Take-Away. *In terms of fairness to both sides, the use of a note and trust deed is equally balanced – i.e. the buyer can “cure” the default all the way up to five days before the foreclosure sale, but after that, the only way to save the property is to pay the full accelerated amount of the debt before auction; thereafter, the sale is absolute, and the seller (or highest bidder at the sale) gets the property almost immediately, without having to wait for the period of redemption to run.*

Land Sale Contract. Generally, the seller has a wide range of remedies which are enumerated in the contract. Most are not addressed in the Oregon statutes. The judicial remedies range from “strict foreclosure” where the seller forecloses through the court system, and gets the property back; judicial foreclosure, where the seller also forecloses through court, and a public sale is held; to specific performance, where the seller could actually sue to “force” the buyer to buy the property, and pay the proceeds due under the contract.⁸ There is one statutory remedy; it is called “forfeiture,” which permits the seller to non-judicially foreclose by following certain mailing procedures, and recording an affidavit of forfeiture at the conclusion of the process. It is not dissimilar to the non-judicial foreclosure process for trust deeds. It is relatively quick, and does not entail any deficiency liability to the buyer. See, [ORS 93.505 – 93.945](#).

- *Seller Advantage:* Seller’s range of remedies is broader – i.e. he/she can decide at the time of default, what remedy to pursue. For example, if the property had markedly increased in value, statutory forfeiture might be appropriate; if it had dropped in value, judicial foreclosure with a deficiency judgment might be appropriate.
- *Seller Advantage:* It is generally perceived that the more highly leveraged the transaction is, i.e. the lower the buyer’s down payment, the more appropriate it is to use land sale contract. This is because the seller can act more swiftly, possibly with a larger “hammer,” and not have to contend with a buyer who defaults under a trust deed, then cures, then defaults again. Upon default, the seller can accelerate the unpaid balance due under the contract, and immediately pursue foreclosure. If the buyer has no defense to the default, the seller can file the foreclosure complaint in court, seek “summary judgment” and possibly recover the property back in a matter of months – plus seek recovery of attorney fees.
- *Buyer Advantage:* The only real “advantage” that a buyer can and should try to secure if a land sale contract is used, is to soften the default provisions so they may not be triggered in a harsh and unexpected manner. This would be to require a fair “grace period,” meaning that before a default in payment may be declared, there be a fair period, e.g. ten days, which would only commence following the seller’s issuance of a written notice to the buyer.⁹

Miscellaneous. Listed below are some general observations about trust deeds and land sale contracts:

⁸ Sometimes this remedy is not included in the seller remedies section of the land sale contract. In reality, the right to sue the buyer for specific performance is typically a meaningless remedy, since a buyer in breach is unlikely to have the money to pay off the contract entirely – hence the breach. Moreover, the buyer’s debt can be discharged in bankruptcy.

⁹ Note, however, that even when a seller agrees to this, he or she may reserve the right to eliminate the written notice requirement, or shorten the grace period, if the buyer goes into default more than, say, once in any one 12-month period.

Note that the above discussion about seller carry-back transactions assumes the property is lien free, i.e. there is no bank loan in a first position, already recorded against the property. If there is, and it is not going to be paid off, if the parties agree, they could do a “wrap” transaction (also known as an “All-Inclusive” Deed of Trust or Contract), whereby the first lien would not be disturbed, and the seller’s carry back security instrument would be subordinate to the bank’s first position lien. These transactions can be risky for reasons beyond the scope of this article. Suffice it to say, there are two important issues that must be addressed in wrap transactions: (a) The seller and buyer must have an “allocation of risk” provision in the security instrument, identifying whether seller or buyer will assume the risk if the underlying lender accelerates the loan balance on account of the transaction; (b) The buyer should insist upon some means of verification that the seller is paying all installments on time. This is sometimes accomplished through the use of a collection escrow, although doing so can slow down the buyer’s payment of the balance of funds to the seller; and how will casualty insurance be handled? If the lender receives notice that their borrower’s name has been replaced by a new party, that’s a pretty good indication to them that the property has likely been sold in violation of the standard due-on-sale clause in most security instruments.

Land sale contracts pose potential issues if there is no fulfillment deed in escrow and the seller should pass away.

The utility of seller carry-back transactions has been clouded by the Consumer Finance Protection Bureau’s rules that went into place in January 2014. [See, post here](#). A discussion of those rules is well beyond the scope of this article, and parties considering a carry-back transaction should first consult legal counsel familiar with the regulatory issues.

Conclusion. My personal preference in almost all most cases is to use a promissory note and trust deed in those transactions in which the seller is comfortable with the buyer’s financial information and credit history, and the down payment is not something he/she could easily walk away from – e.g. 15% or more.

The reasons for my preferences are: (a) The fact that title is transferred at the outset of the transaction; (b) Upon default, the trust deed foreclosure process is fast and final; (c) It is fair to the buyer, i.e. he/she has an absolute right to cure up to five days before the sale date; (d) The trade-off is the entire indebtedness is accelerated five days before the sale, and there is no 180-day period of redemption; and (e) Lastly, the fact that trust deed foreclosures are non-judicial gives assurance that the unpleasantness won’t wind up in a long and public court battle, as is possible with the foreclosure of a land sale contract.

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